IN THE SUPREME COURT OF TEXAS

NO. 04-1004

HOOVER SLOVACEK LLP,
FORMERLY HOOVER, BAX & SLOVACEK, L.L.P., PETITIONER,

v.

JOHN B. WALTON, JR., RESPONDENT

ON PETITION FOR REVIEW FROM THE
COURT OF APPEALS FOR THE EIGHTH DISTRICT OF TEXAS

Argued December 1, 2005

JUSTICE HECHT, joined by JUSTICE MEDINA and JUSTICE WILLETT, dissenting.

No rational plaintiff changes lawyers midway through a case in order to recover less, and John B. Walton, Jr. was not irrational. So when he retained what is now the law firm of Hoover Slovacek LLP to collect royalties for oil and gas produced on his 32,500-acre ranch for a contingent fee of 28.66% of any recovery, he must have reasoned that if he had to discharge the firm it would be to maximize recovery, in which event the firm should not receive a percentage of the final recovery and thereby benefit from services rendered by the new lawyers but should be paid only what the fee was worth at the time of discharge. Without an agreement on the subject, if Hoover Slovacek were discharged for good cause, it would have the right to be paid the value of its services rendered,

but if it were discharged without good cause, it would be entitled to its full contingent fee from the final recovery.[1] Walton and Hoover Slovacek agreed instead that if he terminated the representation, with or without cause, he would "immediately pay the Firm the then present value of the Contingent Fee". Hoover Slovacek would not receive a percentage of the final recovery if discharged without cause, and Walton would pay the value of the fee, which could take into account more than the time spent and thus might be more or less than the value of the services rendered by the firm based on an hourly rate.

What appears to have been a good-faith effort by lawyer and client to reach a fair arrangement for handling the difficult possibility of estrangement was, according to the Court, *unconscionable*, meaning that "a competent lawyer could not form a reasonable belief that the fee is reasonable."[2] This, of course, does not reflect very well on Hoover Slovacek or its distinguished counsel in this case, who have advocated the reasonableness of the fee, and the Court's condemnation of what might appear to be a rather innocuous fee agreement may also come as a surprise to a large number of other lawyers who have up until now considered themselves competent.

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[1] *Mandell & Wright v. Thomas* 441 S.W.2d 841, 847 (Tex. 1969) ("In Texas, when the client, without good cause, discharges an attorney before he has completed his work, the attorney may recover on the contract for the amount of his compensation." (citing *Myers v. Crockett*, 14 Tex. 257 (1855); *White v. Burch*, 19 S.W.2d 404 (Tex. Civ. App.—Fort Worth 1929, writ ref'd); *White v. Burch*, 33 S.W.2d 512 (Tex. Civ. App.—Fort Worth 1930, writ ref'd); *Cottle County v. McClintock & Robertson*, 150 S.W.2d 134 (Tex. Civ. App.—Amarillo 1941, writ dism'd judgment cor.))). One might well think that the most the client would owe in such circumstances would be the contractual fee prorated for the services the lawyer actually performed. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 40 cmt. c (2000) ("Allowing a discharged or withdrawing lawyer to recover compensation under a fee contract with the client is sometimes more appropriate . . . where the client discharges a contingent-fee lawyer without cause just before the contingency occurs, perhaps in order to avoid paying the contractual percentage fee. . . . [T]he contractual fee is prorated for the services actually performed . . . ."). But that is not Texas law, and the parties in this case have not suggested it should be.

[2] TEX. DISCIPLINARY R. PROF'L CONDUCT 1.04(a) ("A fee is unconscionable if a competent lawyer could not form a reasonable belief that the fee is reasonable.").

Worse still, the Court says, the agreement violated public policy, which means, not that it was bad, but that it "contravene[d] some positive statute or some well-established rule of law".[3] The Court does not actually identify a statute or rule of law that has been contravened, and truthfully, none has been. In fact, the agreement has done no devilry at all. To be sure, Walton and Hoover Slovacek have fought hard over how much is owed, the firm claiming at least $1.7 million (28.66% of $6 million, which Walton once may have thought his claims were worth), maybe more, while the client admits to owing no more than $257,940 (28.66% of the $900,000 his claims actually settled for), and maybe nothing at all. But fighting over an agreement does not make the agreement unconscionable and against public policy, or the number of valid agreements would be much smaller.

What does make an agreement unconscionable and against public policy, according to the Court, is not its terms, which seem fair enough in this case, or any consequence to the parties, as yet unrealized here, but what *might* happen if the agreement were made between other parties or in other circumstances. If a court can imagine circumstances in which an agreement *could be* unconscionable — and here, the Court has tried to list every conceivable way that could happen, and then some — it *is* unconscionable. Here are the seven reasons the Court gives for holding this termination fee agreement unconscionable and against public policy:

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[3] *Lawrence v. CDB Servs., Inc.*, 44 S.W.3d 544, 553 (Tex. 2001) ("'Public policy, some courts have said, is a term of vague and uncertain meaning, which it pertains to the law-making power to define, and courts are apt to encroach upon the domain of that branch of the government if they characterize a transaction as invalid because it is contrary to public policy, unless the transaction contravenes some positive statute or some well-established rule of law.'"); *Town of Flower Mound v. Stafford Estates Ltd. Partnership*, 135 S.W.3d 620, 628 (Tex. 2004); *Texas Commerce Bank, N.A. v. Grizzle*, 96 S.W.3d 240, 250 (Tex. 2002);.*Churchill Forge, Inc. v. Brown*, 61 S.W.3d 368, 373 (Tex. 2001).

- *The agreement does not distinguish between discharges with and without cause.* True, but surely a lawyer and client can agree to a termination fee that avoids wrangling over whether discharge was with or without cause, given the intrinsic uncertainties in that issue. Walton and Hoover Slovacek settled on a termination fee that Walton, at least, surely thought would be less than a percentage of the ultimate recovery, and the firm, perhaps, thought might be more than the value of services rendered at an hourly fee. Mere compromise is not unconscionable, but if it were, no matter here. Walton undertook to prove that he discharged Hoover Slovacek with cause but failed to convince the jury, so even if the agreement had drawn the distinction, he could not take advantage of it. At this point, the distinction is irrelevant.

- *If the contingent fee were worth more at the time of discharge than at the end of the case, it would be a bad deal for the client.* So it would, but a fee agreement is not unconscionable and against public policy merely because it *could* be a bad deal for the client. As noted at the outset, a rational plaintiff does not change lawyers to recover less, and if that is what Walton did, he has himself to blame. The Court criticizes this agreement because it would benefit the client only when the claim is improved by changing lawyers, but since the client is in control, benefit to the client should always be intended and, absent misjudgment, achieved. Moreover, there is no evidence in *this case* that Hoover Slovacek's contingent fee was ever worth more than it would have been at the end of the case. If the fee was worth as much at discharge as it would have been at the end, the agreement gave the firm only what Texas law would if there had been no termination clause, since it has not been established that discharge was for cause. Walton *could* have made a bad deal, but there is no evidence he *did*.

- *Ascertaining the value of a contingent fee mid-case is hard.* There is some tension between this argument and the previous one, which assumes that a contingent fee can be valued before the end of the case to the client's detriment. Actually, the value of a contingent fee mid-case may well be impossible to prove with sufficient certainty for recovery, even in a case like this one involving only economic damages. Walton's lawyer first demanded $58.5 million to settle, the defendants countered with $6 million and conditions, Walton demanded $6 million without conditions, the defendants offered $300,000, and the case finally settled for $900,000, due largely to new and unforeseen developments. Walton discharged Hoover Slovacek 22 months into a 42-month-long case. What was Hoover Slovacek's contingent fee worth at discharge? That question has been fully tried but has still not been answered — there is no evidence what a willing buyer would have paid a willing seller for a claim like Walton's the day he discharged Hoover Slovacek — and it may not be answerable. Even if the audit of royalty payments Walton commissioned had been completed, uncertainties remained in determining whether he had been underpaid. But the Court seems not to notice that Hoover Slovacek bears the burden of proving the value of its fee, and any difficulty in carrying that burden does not prejudice Walton, it benefits him.

- *A lawyer who knows that the value of a claim is declining has an incentive to misbehave, provoke discharge, collect more than he would in the end, and turn to more lucrative business.* This argument rejects what the previous one asserts, that the value of a contingent fee is hard to predict. But more importantly, the Court appears to assume a jurisdiction in which lawyers do not owe clients a fiduciary duty, the intentional breach of which is a tort remedied by actual and exemplary damages. A lawyer as wicked as the Court's imagination may be more deterred by the

threat of punitive damages than the threat of a voided contract. In any event, no evidence in this case hints at anything even approaching this *pollo poco* nightmare.

- *The agreement required Walton to pay up at discharge.* But if there had been no agreement, Walton would undisputedly have been required to pay Hoover Slovacek at discharge the value of its services rendered. The impoverished client the Court hypothesizes — certainly not Walton — who could afford representation only on a contingent fee, would be required to pay for the value of the discharged lawyer's services at termination. To agree to what the law would otherwise provide can hardly be unconscionable. Even so, it *would in fact have been* no burden on Walton. He could have paid Hoover Slovacek, just as he paid his new lawyers $283,000 at an hourly rate. And in any event, in over nine years, Walton has not yet paid Hoover Slovacek one cent for prosecuting his claims against the Bass defendants.

- *The agreement violated professional rule 1.08(h) by allowing Hoover Slovacek to acquire an interest in Walton's claim other than by a contingent fee authorized by rule 1.04.* Here the circularity is dizzying. To restate the argument: if the agreement was unconscionable in violation of rule 1.04 of the Texas Disciplinary Rules of Professional Conduct, it gave Hoover Slovacek an interest in Walton's claim prohibited by rule 1.08(h), which excepts only interests created by an agreement valid under rule 1.04, which this agreement was not, if indeed it wasn't. If the termination fee was not unconscionable, rule 1.08(h) is inapplicable, and if the termination fee was unconscionable, rule 1.08(h) is inconsequential. Either way, rule 1.08(h) is irrelevant.

- *A client should not reasonably expect a contingent fee to equal or exceed the recovery.* Certainly not, but even if that *could* ever occur with a termination fee like the one in this

case, and it is not at all clear that it ever could, it *has not happened* in this case. Walton settled for $900,000, and there is no evidence that he owes Hoover Slovacek more than 28.66% of that amount. The Court notes that its concerns do not extend to hourly fee agreements, but it is not clear why only contingent fees are subject to abuse.[4]

In sum, the Court "believe[s] Hoover's termination fee provision is unreasonably susceptible to overreaching, exploiting the attorney's superior information, and damaging the trust that is vital to the attorney-client relationship."[5] Although I think the Court's arguments are strained at best, even if they had more substance, a fee agreement should not be voided as unconscionable and against public policy based merely on what *could* happen but was not intended and has not in fact occurred. It *could have happened* that Hoover Slovacek provoked its own discharge for nefarious reasons, or that Walton discharged Hoover Slovacek for cause, or that when he did, the termination fee exceeded the contingent fee, or that he was somehow prejudiced by the difficulty in evaluating the termination fee, or that he had to pay before any recovery was realized, or that the fee exceeded his recovery. Any of these things *could have happened*, but *none did*. Walton and Hoover Slovacek anticipated exactly what occurred and tried to make suitable provision for it. Whether their agreement was unconscionable, and therefore abhorrent to public policy and void, should be determined by their

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[4] *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 34 cmt. c (2000) ("Accordingly, the reasonableness of a fee due under an hourly rate contract, for example, depends on whether the number of hours the lawyer worked was reasonable in light of the matter and client. It is also relevant whether the lawyer provided poor service, such as might make unreasonable a fee that would be appropriate for better services, or services that were better or more successful than normally would have been expected . . . .").

[5] *Ante* at ___.

initial expectations and the actual consequences, not on hyperbolic hypothesizing in hindsight. As the comment to rule 1.04 states:

> [F]ee arrangements normally are made at the outset of representation, a time when many uncertainties and contingencies exist, while claims of unconscionability are made in hindsight when the contingencies have been resolved. . . . Except in very unusual situations, therefore, the circumstances at the time a fee arrangement is made should control in determining a question of unconscionability.[6]

Agreements are unconscionable when they are not or cannot be proper, not when it is merely possible for them to be improper.

Again, it matters not whether the parties have behaved admirably throughout. Walton does seem to have had an inflated view of the value of his claims (about 900%), though perhaps no more than many clients, and he may not have had good cause to discharge Hoover Slovacek — at least he could not convince a jury he did. And Hoover Slovacek may have been overly aggressive, at first in pursuing the defendants (demanding $58.5 million to settle a $900,000 claim) and then in pursuing Walton (demanding millions for a legal fee worth $257,940). But Hoover Slovacek's lawyers are not here on disciplinary charges, and Walton is not applying for Client of the Year. An agreement is not unconscionable because a party acts unconscionably — and there is certainly no evidence that Walton or Hoover Slovacek did.

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[6] TEX. DISCIPLINARY R. PROF'L CONDUCT 1.04 cmt. 7; *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 34 cmt. c ("Although reasonableness is usually assessed as of the time the contract was entered into, later events might be relevant. . . . [E]vents not known or contemplated when the contract was made can render the contract unreasonably favorable to the lawyer or, occasionally, to the client. . . . To determine what events client and lawyer contemplated, their contract must be construed in light of its goals and circumstances and in light of the possibilities discussed with the client . . . .").

If the Court is serious about today's analysis, many more fee agreements and other contracts will be unconscionable. The Court says that "[h]ourly fee agreements . . . do not implicate the [same] concerns" it has about the agreement in this case,[7] but they do. Fees based on hourly rates seemingly reasonable at the outset *could* end up being excessive in easily imaginable circumstances, but that mere potential does not invalidate an agreement.

But the Court may not be serious. It may be that today's decision will be limited to this one particular fee agreement in this one isolated situation, portending nothing for fee agreements in general.[8] If so, then the rules governing fee agreements will merely have a minor exception, and only the Court's authority to articulate general rules will suffer. Of course, the careful lawyer on a contingent fee can simply charge what the law allows for termination of representation without good cause: the full fee. The client will be penalized for changing lawyers and will pay for services not rendered, but it will not be unconscionable.

We have taken as given that the only fee a Texas lawyer is prohibited from charging is one that is illegal or unconscionable because that is what rule 1.04(a) of the Texas Disciplinary Rules of

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[7] *Ante* at ___.

[8] *See County of Cameron v. Brown*, 80 S.W.3d 549, 565-566 (Tex. 2002) (Hecht, J., dissenting) ("It may be, however — one cannot always tell for sure — that the Court does not really mean what it says. . . . [I]t may be that this case is just another 'restricted railroad ticket, good for this day and train only.'" (citing *Smith v. Allwright*, 321 U.S. 649, 669 (1944) (Roberts, J., dissenting))).

Professional Conduct provides.[9] In most states, lawyers cannot charge unreasonable fees;[10] not so in Texas. In Texas, a lawyer is prohibited only from charging a fee that a competent lawyer could not reasonably believe to be reasonable.[11] Of course, Texas law does not *award* lawyers unreasonable fees, so one could argue that notwithstanding rule 1.04(a), a lawyer suing to collect a fee must prove that it is reasonable, not merely that it is not unconscionable. In matters other than lawyer discipline, the Disciplinary Rules of Professional Conduct have been held to "provide guidelines and suggest the relevant considerations" without supplying the rule of decision,[12] and one

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[9] TEX. DISCIPLINARY R. PROF'L CONDUCT 1.04(a) ("A lawyer shall not enter into an arrangement for, charge, or collect an illegal fee or unconscionable fee.").

[10] ALASKA R. PROF'L CONDUCT Rule 1.5(a); ARIZ. R. PROF'L CONDUCT ER 1.5(a); ARIZ. R. PROF'L CONDUCT, ER 1.5(a); ARK. R. PROF'L CONDUCT, Rule 1.5(a), (e)(3); COLO. R. PROF'L CONDUCT Rule 1.5(a), (f); COLO. R. CIV. P. Ch. 23.3 (contingent fees), Rules 3, 7; CONN. R. PROF'L CONDUCT, Rule 1.5(a); DEL. R. PROF'L CONDUCT , Rule 1.5(a); D.C. R. PROF'L CONDUCT Rule 1.5(a); GA. R. PROF'L CONDUCT Rule 4-102, Rule 1.5(a); HAW. R. PROF'L CONDUCT Rule 1.5(a); IDAHO R. PROF'L CONDUCT Rule 1.5(a); ILL. R. PROF'L CONDUCT Rule 1.5(a); IND. R. PROF'L CONDUCT Rule 1.5(a); KAN. R. PROF'L CONDUCT Rule 1.5(a), (e) (court review); KY. R. PROF'L CONDUCT SCR 3.130(1.5(a)); LA. R. PROF'L CONDUCT Rule 1.5(a), (f)(5) (unearned fee/expense deposit/retainer provision); MD. R. PROF'L CONDUCT Rule 1.5(a); MINN. R. PROF'L CONDUCT Rule 1.5(a); MISS. R. PROF'L CONDUCT Rule 1.5(a); MO. R. PROF'L CONDUCT Rule 4-1.5(a); MONT. R. PROF'L CONDUCT Rule 1.5(a); NEV. R. PROF'L CONDUCT Rule 155.1; N.J. RULES PROF'L CONDUCT RPC 1.5(a); N.M. R. PROF'L CONDUCT RULE 16-105(A); N.D. R. PROF'L CONDUCT Rule 1.5(a); OKLA. R. PROF'L CONDUCT Rule 1.5(a); R.I. R. PROF'L CONDUCT Rule 1.5(a); S.C. R. PROF'L CONDUCT Rule 1.5(a); S.D. R. PROF'L CONDUCT Rule 1.5(a); TENN. R. PROF'L CONDUCT Rule 1.5(a); VT. R. PROF'L CONDUCT Rule 1.5(a); VA. R. PROF'L CONDUCT Rule 1.5(a); WASH. R. PROF'L CONDUCT Rule 1.5(a); W. VA. R. PROF'L CONDUCT Rule 1.5(a); WIS. R. PROF'L CONDUCT SCR 20:1.5(a); and WYO. R. PROF'L CONDUCT Rule 1.5(a). *See also* ABA MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(a) (no "unreasonable" fees or expenses) (1983); ABA ETHICS 2000 REVISED MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(a), (e)(3) (2003); and RESTATEMENT OF THE LAW GOVERNING LAWYERS §§ 34-35 (contingent fees, incorporating §34)(2000).

[11] *See supra* note 2.

[12] *In re Users System Services, Inc.,* 22 S.W.3d 331, 334 (Tex. 1999); *In re EPIC Holdings, Inc.*, 985 S.W.2d 41, 48 (Tex. 1998); *National Medical Enterprises, Inc. v. Godbey*, 924 S.W.2d 123, 132 (Tex. 1996); *Henderson v. Floyd*, 891 S.W.2d 252, 254 (Tex. 1995) (per curiam); *Spears v. Fourth Court of Appeals*, 797 S.W.2d 654, 656 (Tex. 1990); *Ayres v. Canales*, 790 S.W.2d 554, 556 n.2 (Tex. 1990).

could argue that the role of rule 1.04(a) in enforcing fee agreements is similarly limited.[13] But none of the parties here does.

The Court remands the case to the trial court to allow Hoover Slovacek to recover its contingent fee in the interest of justice. In the end, Hoover Slovacek may recover as much or more without the termination fee provision. This is certainly an odd way of applying unconscionability, not to mention the interest of justice. I would enforce the termination fee agreement. Accordingly, I respectfully dissent.

Nathan L. Hecht
Justice

Opinion delivered: June 30, 2006

[13] *Cf. Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 205 (Tex. 2002) (referring to Rule 1.04 to determine a permissible referral fee); *Bocquet v. Herring*, 972 S.W.2d 19, 21 (Tex. 1998) (referring to Rule 1.04 for factors indicating reasonableness of attorney fee); *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 818 (Tex. 1997) (same).